



Energy Overview

South Africa's economy is centred around the energy sector, with high energy intensity and well-developed electricity networks, boasting the highest rates of electricity access in sub-Saharan Africa. The country's energy supply is dominated by coal, followed by crude oil, renewables, and nuclear power. It is the 7th largest coal producer in the world. Coal plays a crucial role in South Africa's energy sector, meeting 80% of the country's primary energy needs and powering 92% of its electricity supply.

The South African government has implemented measures to increase the presence of renewable energy in the energy mix and to oversee the procurement and development of utility-scale renewable energy projects. The measures implemented rely on policy changes, inter-governmental cooperation, and committing to an implementation agreement as a form of government support for each project that has concluded a Power Purchase Agreement (PPA) under the Renewable Energy Independent Power Producer Procurement Programme (REIPPP Programme). The key elements behind supporting renewables are energy security, rapid project development, and reducing the country's carbon footprint. Companies and government continue to face increasing pressure to place a focus on renewables as a preferred energy alternative and move away from fossil fuels as an energy source.

South Africa signed the Paris Agreement in April 2016 and endorsed the submission of its Nationally Determined Contribution (NDC). The NDC requires that emissions peak in 2020 to 2025, plateau for a ten-year period from 2025 to 2035 and declines from 2036 onwards. The Paris Agreement will require sizable reductions in energy-related carbon dioxide in large emitters.

Tax Overview

The Constitution of the Republic of South Africa establishes a unitary but decentralised system of intergovernmental relations by providing for three distinct spheres of government: national, provincial, and local. The South African Revenue Service (SARS) is the country's national receiver of revenue. SARS administers a number of tax Acts in terms of which money (taxes, duties, and levies) is collected and paid into the National Revenue Fund.

Income tax is the government's main source of income and is levied pursuant to the Income Tax Act 58 of 1962. VAT is levied the VAT Act 89 of 1991 at a standard rate of 15% on the supply of goods and services by registered vendors. South Africa imposes the following withholding taxes on payments which are made to non-residents:

- ❖ dividends paid by resident companies: 20%
- ❖ interest paid by any person: 15%
- ❖ royalties paid by any person for the use of IP: 15%
- ❖ purchasers of immovable property: 7.5% (if the non-resident seller is a natural person; 10% (if the non-resident seller is a company and 15% (if the non-resident seller is a trust).

These rates of withholding tax may be reduced if the non-resident's county of residence has a double tax agreement with South Africa which provides for reduced rates of withholding tax.

The country operates a residence-based taxation system, requiring residents to pay taxes on their global income regardless of where it was earned. Non-residents are taxed on their income from a source in South Africa with appropriate relief to avoid double taxation. Companies are considered to be residents of South Africa if they are incorporated or have their place of effective management in South Africa.

South Africa's fiscal approach has consistently been in step with the nation's transition from dependence on fossil fuels to the adoption of a strategy focused on reducing carbon emissions. It imposes carbon fuel levies which are embedded in the price of petrol and diesel, an electricity levy on non-renewable electricity generation, a carbon tax on carbon dioxide equivalent emissions, taxes on incandescent light bulbs and a motor vehicle carbon dioxide emissions tax.

Taxation of Energy Projects

Energy projects in South Africa can be funded through different sources and mechanisms. One way is through project finance, where funding is obtained for a specific energy project based on its cash flow and assets. Lenders typically assess the project's feasibility and risk profile. This approach is commonly utilised for large-scale projects like power plants and renewable energy facilities. Energy projects can be financed through debt, where funds are borrowed from banks, financial institutions, or bond markets. Alternatively, they can be financed through equity financing, which involves raising funds by selling shares or ownership stakes in the energy project to investors. Government grants and subsidies, such as the REIPPP programme, offer competitive bidding, particularly for renewable energy projects, and provide financial support through mechanisms such as PPAs. Another financing option for energy projects, especially those that reduce greenhouse gas emissions, is carbon financing through mechanisms such as carbon credits or carbon offset projects.





As most energy projects are carried out by companies, these projects attract corporate income tax at the rate of 27%. They are also often subject to VAT on the sale of goods and services. Imported equipment and materials used in energy projects may be subject to customs duties. Other taxes that an energy project may attract are: carbon tax, dividends tax, tax on royalties, and employment taxes.

Below are some key phases of an energy project as well as some of the tax considerations that are important to note:

- ❖ **Project development phase:** During the project development stage, various taxes may be attracted depending on the nature of the project, its location and the activities involved. Typically, during this phase of an energy project, income-generating activities may not have commenced while on the other hand, certain expenses are being incurred which may still be subject to corporate income tax. VAT may be levied on goods and services acquired during this stage such as feasibility studies, engineering services, and the procurement of equipment.
- ❖ **Project construction phase:** VAT may also be levied on construction-related expenses including the procurement of materials, equipment, and services. Capital allowances may be applicable in relation to certain qualifying capital expenditures incurred during this phase.
- ❖ **Project commercial operation phase:** At this stage of an energy project some key tax considerations include corporate income tax, VAT, carbon tax, capital allowances on qualifying capital expenditure, as well as compliance with tax laws and regulations which includes filing tax returns and maintaining proper records.

Other Tax Issues To Be Considered

There are also various tax incentives contained in the Income Tax Act for energy projects in South Africa such as the renewable energy tax incentive. This section specifically allows for the deduction of a portion of the cost of qualifying assets from taxable income over a specified period. Businesses may also be entitled to claim a tax deduction based on prescribed energy efficiency savings achieved over a 12-month period. Deductions may also be allowed for expenditure incurred on scientific research and development, meaning that energy projects involving innovative technologies or processes may qualify for it.

In addition to the specific tax provisions and incentives already mentioned, when undertaking an energy project in South Africa, there are various other considerations at play. Energy projects sometimes involve transactions with related parties, such as the procurement of equipment or service agreements which may be subject to transfer pricing rules.

Another consideration is that South Africa has transfer pricing and thin capitalisation rules which limit the deductibility of interest expenses on incorrectly priced debt financing in certain situations. An intra-group loan would be incorrectly priced if the amount of debt funding, the cost of the debt or

both are excessive compared to what is arm's length. Any interest or finance charges on the non-arm's length amount of debt must be disallowed as a deduction (primary adjustment).

In addition to the primary adjustment, a taxpayer may also be subject to dividends tax on the amount of the disallowed deduction.

Capital gains tax must also be considered as it may apply to the disposal of assets used in energy projects such as property, plant, and equipment.

Relevant Experience

- ❖ ENS has worked on many of South Africa's largest and most innovative energy projects. Set out below is a representative sample of some of our work in this sector:
- ❖ Eskom Holdings SOC Limited, in its reorganisation into separate generation, transmission and distribution entities
- ❖ Eskom Holdings SOC Limited, on the tax treatment of electricity supply agreements with its key customers
- ❖ Eskom Holdings SOC Limited, on the tax treatment of certain aspects of a Construction and/or Erection All Risks and Public Liability insurance policy in respect of the Eskom capital expansion programme
- ❖ Hyphen Hydrogen Energy (Pty) Ltd, on various matters in respect of the development of a green hydrogen project in Namibia
- ❖ Global Energy Alliance for People and Planet, on the establishment of their South African operations
- ❖ City Power Johannesburg SOC Limited, on the carbon tax implications of a power purchase agreement with Kelvin Power Proprietary Limited
- ❖ African Rainbow Energy and Power (Pty) Ltd, on certain aspects of the private equity fund established by it to hold equity investments in various renewable energy projects
- ❖ Ergo Mining (Pty) Ltd, on various aspects in respect of a solar photovoltaic power plant and battery storage project
- ❖ Scatec Kenhardt 1 (RF) Pty Ltd, on the tax treatment of its Engineering, procurement and construction (EPC) contract in relation to the design, execution, completion and commissioning of its renewable energy project.



KEY CONTACT

Mansoor Parker

Executive

ENS Africa

Taxand South Africa

mparker@ENSafrica.com

+27 83 680 2074

